

August 5, 2003

Honorable Mayor and Members
of the City Council
City of Walled Lake
1499 East West Maple
Walled Lake, MI 48390

Dear Mayor and Council Members:

We have recently completed our audit of the financial statements of the City of Walled Lake for the year ended June 30, 2003. In connection with this, we offer the following comments and recommendations.

Segregation of Duties – Bank Reconciliations

In planning and performing our audit of the City's financial statements each year, we consider the City's internal control structure in order to determine our audit procedures for the purposes of expressing our opinion on the financial statements. The consideration we give to the internal control structure is not sufficient for us to provide any form of assurance. However, as we have reported to you in the past, our review of the City's internal control structure and operation leads us to an assessment that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. With the recent change in the City's management, we believe that this may be an appropriate time to bring this to your attention again.

Reportable conditions are significant deficiencies in the design or operation of the internal control structure that have come to our attention and, in our judgment, could adversely affect the City's ability to record, process, summarize and report financial data consistent with the City's management assertions inherent in the financial statements. We consider the following deficiencies in the design and operation of the internal control structure to be a reportable condition.

One employee has the ability to record, process, and manage cash. This same individual performs the monthly bank reconciliation. We understand that due to the size of the City's accounting department, it is difficult to adequately segregate duties. However, we believe that it would strengthen internal control if an additional person could be brought into the bank reconciliation process. One method would be to identify someone independent of the cash collection, recording, and processing functions perform the monthly bank reconciliation. Alternatively, such an individual could be asked to review the monthly bank reconciliations (and initial them to document the review).

Furthermore, introducing a new individual may assist the City in investigating any reconciling differences (during the current year, we noted that the bank reconciliations continued to carry a miscellaneous, unreconciled difference).

Water and Sewer

At the beginning of the fiscal year, the City transitioned to a new accounting system. Partially because of the transition, water and sewer subsidiary accounting records were not reconciling with the general ledger. These issues have since been discovered by the accounting department and the appropriate actions have been taken to rectify the situation.

State Revenue Sharing

As you are aware, the state continues to anticipate reduced tax revenues, which caused Governor Engler to enact a 3.5 percent reduction in state shared revenue for the year ended September 30, 2003 and Governor Granholm to propose a further 3 percent reduction for the year beginning October 1, 2003 through September 30, 2004. State shared revenue currently represents approximately 15 percent of the City's General Fund revenue. The City should continue to closely monitor the effects these changes will have on the City's 2004 budget.

Personal Property Tax

During the 2000 tax year, the State Tax Commission revised the tables used to place taxable values on personal property. Most communities continued to use the old tables for utility transmission and distribution property, since it was the subject of litigation in the Michigan Tax Tribunal. This case has recently concluded in favor of the plaintiff. The City has disclosed in their 2003 financial statements, the potential impact of this decision and set aside approximately \$80,000 in fund balance to cover any potential refunding situations.

ACH Arrangements

Recently, Public Act 738 was passed, which allows local units of government to make and accept electronic funds transfers (ACH payments), if the local unit adopts a formal policy. While local units of government may have already been using the ACH system for payroll tax remittances and for the direct deposit of payroll, this new law requires a policy to be adopted.

The City Council should consider adopting a policy on ACH arrangements that includes all of the following:

- Designation of an individual as the party responsible for approving payment, accounting, reporting and complying with the ACH policy;
- A statement that this individual is required to submit documentation as follows:
 - Describe the goods or services purchased,
 - The cost,
 - Date of payment, and
 - The department benefiting from the purchase;
- A system of internal controls to monitor the use of ACH transactions; and
- The approval of ACH invoices before payment.

Computer Security

The public sector is in the process of making government services more available on-line. This trend, commonly referred to as "e-government," is a significant step forward in making government more accessible to residents.

However, we are finding that local governments need to spend an equal effort in preventing cyber-crimes¹ & cyber-terrorism². While the private sector has been forced to devote significant resources to this area for a couple of years now, organizations in the public sector are beginning to see the need for similar attention. Items for consideration include the ability of employees to access or manipulate data or programs inappropriately, firewalls for Internet access points, and physical security/disaster recovery plans.

An organization's data assets are such that their loss or impaired usage can have devastating consequences. As a result, we strongly recommend that you assess your information systems and network environments and develop strategies to ensure that risks associated with down time, hacker intrusions, Cyber-Crimes, Cyber-Terrorism, and virus attacks are minimized in a secured environment. We believe it is prudent to assess your risk and implement security improvements to avoid the negative implications.

Protecting the City from Fraud

Due to the continued sophistication of devices such as scanners and color copiers, the risk of check fraud is growing. Annual losses due to check fraud in the U.S. are estimated to be beyond \$12 billion. With these devices, dishonest individuals can take a valid check, a canceled check, or a voided check and either duplicate or modify the check for fraudulent use. Making matters worse, where banks once protected their customers for this type of check fraud, sentiment is beginning to change, where ultimately it may be the customer's responsibility to cover fraudulent checks.

To combat this problem, many banks have introduced a tool called "positive pay", which verifies each check presented to the bank against a file of written checks that is electronically transmitted from the customer to the bank. Funds are not relieved from the customer's account unless the check matches the information transmitted or until the customer approves the check. The cost of this tool is very low. A side benefit is that it allows the bank to prepare an outstanding checklist as a by-product of this service.

We recommend that, to the extent the City is not already utilizing this tool, you give consideration to implementing a positive pay system.

¹ Cyber Crime - The deliberate misuse of digital data or information flows.

² Cyber-Terrorism - The deliberate destruction, disruption or distortion of digital data or information flows with widespread effect for political, religious or ideological reasons.

New Reporting Model – GASB 34

As we mentioned last year, the Governmental Accounting Standards Board issued a new pronouncement that will change the presentation of governmental financial statements. The expected benefits of the new model include improved comparability of financial statements between communities, and a better matching of the current year's revenue sources to the full cost of services provided during that year. Some of the changes in the model include the following:

- A "Management's Discussion and Analysis" section
- Government-wide financial statements prepared on a full accrual basis.
- Capital assets and their related depreciation will be reported.

The City will need to fully implement GASB 34 for the year beginning July 1, 2003. It is likely that the adoption of the new reporting model may require several changes to the City's financial systems, especially in relation to fixed assets. Many decisions will need to be addressed and much information will need to be compiled in advance of the implementation date. We will continue to keep the Council and key members of the City's staff up to date regarding this pronouncement and assist any way possible to ensure a smooth transition.

Review of Fee Structure

With many of the City's prime revenue sources limited due to enacted laws and/or State legislative control, it is recommended that the City review its current rate structure utilized in charging for services, licenses, permits and other fees. Due to the increased annual cost associated with providing these services, we recommend that these charges be periodically reviewed for market and cost competitiveness. In determining the appropriateness of the fees, both the direct and indirect costs associated with providing the service along with the amount charged by neighboring communities for similar services should be considered.

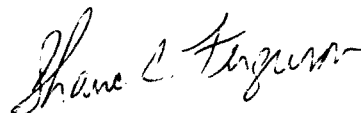
We would like to thank the City personnel for the courtesy and assistance extended to us during the audit. We would be happy to answer any questions or concerns you have regarding the annual financial report and the above comments and recommendations at your convenience.

Very truly yours,

PLANTE & MORAN, PLLC



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